Supreme Court, U. S.
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IN THE

Supreme Court of the United States

October Term, 1977.

No. 77-1725.

COLECO INDUSTRIES, INC.,

Petitioner,

v.

ABE BERMAN, JOSEPH RUBIN, IRVING COHEN, LEWIS M. COHEN, FREDERICK COHEN, ZELNICK, SOBELMAN & COMPANY,

Respondents.

BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI.

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QUESTION PRESENTED.

In answers to interrogatories and in its pretrial memorandum filed a month before trial, a plaintiff states that it will rely on certain data to prove an allegation. A week before trial it determines that such data is irrelevant. It then prepares a sample study of altogether different data to prove the allegation, with no notice to defendants. In the third week of a jury trial it offers testimony based on such study. Does a district court abuse its discretion in precluding such testimony on the ground that its admission would be highly prejudicial to defendants?

STATEMENT OF THE CASE.

On June 4, 1973 Coleco Industries, Inc. (Coleco) acquired the shares of stock of a new competitor in the swimming pool business, Royal All-Aluminum Swimming Pool Corporation (Royal).

In December, 1973 Coleco, which had not yet paid the full purchase price, instituted this litigation claiming several million dollars in damages for alleged violations of Rule 10(b)-5, common law fraud, and breaches of a variety of warranties. Royal's shareholders counterclaimed for the balance of the purchase price. Cross-claims were asserted, *inter alia,* against Royal's accountants.

The petition raises only one issue in what was a very complex, multi-issue trial. The Royal shareholders warranted the correctness of Royal's unaudited financial for its last quarter, which ended April 30, 1973.[1] Coleco alleged a breach of that financial warranty, claiming that in respect of 407 pools manufactured by Royal in that last quarter, the manufacturing costs exceeded by $80,272 the cost revealed in the financial.

Defendants sought to determine the basis of this claim. In Answers to Interrogatories, again in its affidavit attached to its Motion for Partial Summary Judgment filed a month before trial, and again in its Pretrial Memorandum filed two weeks before trial, Coleco stated that it intended to prove the real cost of manufacturing those pools from Royal's invoices for the purchase of materials in the period March through June, 1973. The details of Coleco's pretrial assertions are set out below.[2]

1. The financial was prepared by Royal's accountants and Coleco's in-house accountant during the negotiations which preceded the purchase. Immediately before trial Royal's accountants settled with Coleco for $350,000.

2. Defendants served Interrogatories to determine the basis of the claim. Coleco responded that it had costed out those pools

A week before trial, oral argument was held on Coleco's Motion for Partial Summary Judgment. The undersigned argued that 1973 invoices were irrelevant to the allegation since Royal's 1973 pools were assembled from materials purchased a full year earlier.[3] The Motion for Partial Summary Judgment was denied.

Fifteen days after the jury trial began, Coleco produced its in-house accountant, Hubert, as a witness. The undersigned objected (Tr. 1090 et seq.) that the proferred

2. (Cont'd.)

"using May and June, 1973 invoice prices" and determined that the "costs per pool were significantly higher than the costs which were employed to reduce the inventory as of the April 30, 1973 statement . . ." (Dock. #31, 46)

A month before trial Coleco filed a Motion for Partial Summary Judgment. In its supporting Memorandum (Dock. #155, at pp. 52-54) Coleco stated that in 1973 it prepared revised cost sheets for the Royal pools, using "purchase invoices for July and August of 1973" and that "primarily on the basis of these revised costs" it "initiated this litigation . . ." It further stated that in order to verify its findings, it reviewed March-April, 1973 purchase invoices, and that its in-house accountant, "Mr. Hubert employed March-April, 1973 . . . data so that a determination could be made as to the material costs of the . . . pools at or about the time of preparation of the April 30, 1973 Royal financial statement." Attached to its Motion was Hubert's affidavit (Dock. #157, 173) setting forth in detail its undercosting claim, all of it based on purchase invoices from March, 1973 forward.

Two weeks before trial Coleco filed its Pretrial Memorandum (Dock. #169) stating that it intended to prove that "the physical inventory in August, 1973 was counted by Coleco and Royal personnel and was priced by Coleco and Royal personnel. Subsequent to the August, 1973 physical inventory, cost sheets on the entire Royal pool line were prepared *on the basis of May-June, 1973 invoices prices.*" In the "Witness" section of its Pretrial Memorandum Coleco listed Hubert, and stated that he would testify about "the costing review carried out by Coleco and Royal in August and September, 1973." Other "financial" witnesses were listed but the description of their testimony bore no relation whatever to an examination of any pre-March, 1973 purchase invoices.

3. The irrelevancy of Coleco's proofs were made even more obvious by its vice-president's statement that by April, 1973 there had been "drastic material cost increases". (86a; Ex. U-304)

testimony was expert testimony and Hubert had not been listed as an expert witness in Coleco's pretrial memo. By agreement (Tr. 1135-1136), the court heard Hubert's testimony outside the presence of the jury. The court then decided (Tr. 1178-1182) to permit Hubert to testify as an expert, but that given the nature of his proposed testimony, defendants should have an opportunity to depose him. The court recessed trial so that Hubert could be deposed that night. It was during that deposition—on the evening of the fifteenth day of trial—that defendant learned for the first time that one week before the trial began, with notice to no one, Coleco hired a Philadelphia accounting firm to "sample test" Royal's *1972* invoices in order to produce testimony that 1972 costs did not differ substantially from 1973 costs. The accounting firm spent three weeks doing so.

The next day, Hubert began to testify about 1972 invoices. The undersigned objected that testimony concerning 1972 invoices should be precluded because defendants had learned of the sample testing of 1972 invoices only the night before; the Manual for Complex Litigation recommends that notice of sample tests be given far in advance of trial in order to protect litigants against unreliable evidence; and since thousands of invoices were involved, it would be highly prejudicial to allow in such testimony which defendants could not adequately cross-examine and the accuracy of which they could not verify. (Tr. 1239-1240). The court agreed and ruled that under "all of the circumstances" use of 1972 invoices would be a surprise . . . and would be highly prejudicial to defendants." (Tr. 1256-1258).

ARGUMENT.

I. Coleco's Attempt to Surprise Defendants by the Introduction of Testimony Based on a Statistical Sampling of 1972 Invoices Was Properly Prevented by the District Court.

This case does not involve, as Coleco would have the Court believe, an overly rigid application of a pretrial procedure adopted pursuant to F. R. C. P. 16. The District Court displayed extraordinary flexibility and caution first by hearing Hubert's testimony outside the jury's presence so that the problem could be intelligently assessed, and then by recessing trial to permit the taking of his deposition so that he could testify as an expert even though he had not been designated as such. All of this judicial caution prevented what surely would have been prejudicial error—the surprise introduction of a secretly prepared sample study which defendants could not have tested adequately through cross-examination because they had been misled into believing that Coleco was relying on other evidence entirely.

Coleco's pretrial memo, in which it stated that Royal's invoices for the period March through June, 1973, would be used to prove its theory that inventory was overvalued, was only one of the factors underlying the trial court's decision. For Coleco had also given defendants the same information in answers to interrogatories, and in a memorandum and affidavit in support of its motion for summary judgment. Coleco never amended its answers to interrogatories; it never moved to amend its pretrial statement; nor in any other way did it give the defendants any advance notice that it intended to rely not on 1973 invoices, but on a sample study of 1972 invoices.

One week before trial Coleco realized that its proofs did not support its allegations, when the undersigned, responding to the case as Coleco had stated it, pointed out that the pools in question were made of materials purchased a year earlier. To remedy that defect, Coleco had several choices. It might have requested a continuance of the trial to give its counsel time to compile other data. It might have notified defendants and the court that it was hiring accountants to do a sample study of the appropriate invoices. It could have invited defendants to participate in that study or given them a chance to conduct a parallel study. It could and should have sought leave to amend its pretrial statement through a motion that would have given defendants some minimal notice of its intention to rely on different evidence.

Against this background, the ruling by the trial judge did not turn the trial "into a game of skill" in which "one misstep by counsel [was] decisive to the outcome." (Petition 14). Coleco made more than a misstep. It misled the parties and the court. It, not the court, attempted to turn the trial into a "game," a game of surprise.

We emphasize, as did the court (T.. 1257), the special prejudice which results when a litigant is surprised with the type of sampling evidence involved here. As stated in the Manual for Complex Litigation, § 3.50 p. 131 (Moore's ed.)

> "within this area [sample studies] the protection against unreliable evidence afforded by the traditional orthodox hearsay rule can be supplied only by full disclosure to the adverse party in pretrial proceedings."

The Manual recommends that the data underlying a sample study, the method of interpreting the study, and the

conclusions reached be made available to opposing parties *far in advance* of trial. Manual, § 2.713, 2.70, 2.711. This unusual recommendation reflects the well founded concern that without full opportunity to test its assumptions, a sample study may produce a skewed, false result.

Thus the court properly excluded the testimony in question. But even if the evidence had come in, and even if it had been believed, it would not have changed the result. Royal's accountants paid Coleco $350,000 in settlement of the case on the day before the trial began. That amount more than compensated Coleco for any conceivable loss it might have sustained (105a-106a). Furthermore, the District Court found "that even a $130,000 discrepancy [as opposed to the $49,992 error which the accountants admitted (82a)] with the reduction in profitability which it implies" neither "rendered Royal valueless [n]or caused Royal's failure." (88a, n. 48).

II. The Decision by the Appellate Court Is Not Inconsistent With Other Decisions and Does Not Call for an Exercise of This Court's Supervisory Powers.

Each of the cases which Coleco cites as in conflict with the decision of the Third Circuit is in fact distinguishable.

The court (13a, n. 14) properly distinguished its previous decisions in *Meyers v. Pennypack Woods Home Ownership Association*, 559 F. 2d 894 (3d Cir. 1977) and *Dudley v. South Jersey Metal, Inc.*, 555 F. 2d 96 (3d Cir. 1977). (Coleco Pet. 9).

In *Peter Eckrich & Sons, Inc. v. Selected Meat Co.*, 512 F. 2d 1158 (7th Cir. 1975) (Coleco Pet. 15), the trial court's refusal to hear plaintiff's expert witnesses was reversed because, although plaintiff failed to comply with a pretrial order requiring listing of expert witnesses, plain-

tiff had repeatedly notified both the parties and the court of its intention to call them. Unlike this case, there was no prejudice or surprise.

Similarly, in *McCargo v. Hedrick*, 545 F. 2d 393 (4th Cir. 1976) (Coleco Pet. 15), no prejudice or surprise resulted from plaintiff's failure to comply with an unduly burdensome local rule that required the filing of a detailed pretrial memo. The pretrial dismissal for non-compliance was properly reversed because the rule itself had become an obstacle to the administration of justice. Here Coleco's evidence was excluded because it was prejudicial to defendants, not because it violated some technical or unduly burdensome local rule.

The decision below does not depart from the sound principle that *if the opposing party has not been prejudiced by the delay*, relief will be granted to a party who makes a good faith effort to bring before the court at the *earliest possible time* any questions or problems ordinarily handled at pretrial. *Kozar v. Chesapeake & Ohio Railway Co.*, 320 F. Supp. 335, 374, 377 (W. D. Mich. 1970), affirmed in part, vacated in part, 449 F. 2d 1238 (6th Cir. 1971). Clearly, Coleco was not entitled to avail itself of this principle. See *Thompson v. Calmar Steamship Corp.*, 331 F. 2d 657, 662 (3d Cir.), cert. denied, 379 U. S. 413 (1964) (surprise testimony of witness as a fact witness properly excluded when pretrial memo and answers to interrogatories indicated witness was an expert witness); *Adickes v. S. H. Kress & Co.*, 409 F. 2d 121, 124 (2d Cir. 1968), rev'd. on other grounds 398 U. S. 144 (1970) (exclusion of expert testimony was within trial court's discretion where opposing party was notified only one day before trial that expert would be called); See generally *Clark v. Pennsylvania Ry. Co.*, 328 F. 2d 591, 594-595 (3d Cir. 1964); *Ely v. Reading Co.*, 424 F. 2d 758 (3d Cir. 1970) (district court's rulings in enforcing policies behind pre-

trial procedures should be reversed only for clear abuse of discretion).

Thus this is not a case calling for the exercise by this Court of its supervisory powers over local procedures. Where prejudice to an adverse party constitutes the basis for an exclusionary ruling, the lower courts are already working within appropriate guidelines that require no elaboration by this Court. See *Meyers v. Pennypack Woods Home Owership Association*, 559 F. 2d at 904-905.

CONCLUSION.

The Petition for Certiorari should be denied.

Respectfully submitted,

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